NORBORD Q3 2008 CONFERENCE CALL – CORRECTED TRANSCRIPT
October 24, 2008
11:00 A.M. ET

Operator

Good day everyone and welcome to Norbord's Third Quarter 2008 Earnings Conference Call. As a reminder today's call is being recorded and webcast on Norbord's website at www.norbord.com. Norbord's discussion today may include certain projections and forward-looking statements regarding Norbord's business, future actions, and expected results. These statements are subject to known and unknown risks and future results may differ materially.

For further information on known risks, please see the caution regarding forward-looking information statement in the March 1st, 2008 Annual Information Form and the cautionary statement contained in the forward-looking statement section of the 2007 Management's Discussion and Analysis dated January 31st, 2008.

And now I will turn the call over to Barrie Shineton, President and Chief Executive Officer. Please go ahead, sir.

J. Barrie Shineton, President and Chief Executive Officer

Thanks very much Marcus. Good morning and welcome to Norbord's third quarter conference call. I have Robin Lampard our Senior VP and CFO, and Anita Veel, our Director of Corporate and Regulatory Affairs with me today.

We are going to get right to the numbers and then I will come back at the end of Robin's remarks and talk a little bit about our fourth quarter outlook.

Robin E. Lampard, Senior Vice President and Chief Financial Officer

Thanks, Barrie. Norbord recorded a Q3 loss of $18 million or $0.12 per share this quarter. This compares to a loss of $37 million or $0.25 per share in the prior quarter. Included in our Q2 results was the antitrust settlement charge of $32 million pre-tax. We recorded a negative EBITDA of $9 million in Q3. This compares to positive EBITDA of $1 million in the prior quarter and positive $30 million in same quarter last year.

Benchmark North Central OSB prices averaged $201 in the quarter, up from $179 in second quarter. As you've heard us say for some time now, the South East benchmark is more relevant to Norbord with over two-thirds of our production capacity located in the US South. South East benchmark prices averaged $158 in Q3 or $43 lower than North Central. Prices held up better than we expected in the quarter. We believe this was due to continued widespread production curtailments taken across the industry, the seasonal increase in housing activity, low supply chain inventory levels, and production constraints due to weather related log shortages in some regions.

We have already started to see prices come off in the fourth quarter and we expect this softening will continue through the end of the year with housing starts still in decline and the building season winding down. Barrie will speak to this in more detail in a moment.

Norbord took downtime in the quarter to conserve cash and perform essential maintenance. In North America, Norbord curtailed 102 days of OSB production during the quarter versus 101 days in Q2. Included in this number, is downtime at our two Quebec mills to conserve cash, the continuing reduced operating schedule at Jefferson, Texas, a small amount of downtime related to power and wood issues as a result of the hurricanes, and scheduled essential maintenance at some of our other mills.

Combined this downtime represented just over 10% of our total quarterly OSB production capacity. Year-to-date about 15% of Norbord's North American OSB capacity has been curtailed. This is significantly lower than the industry average which APA (the Engineered Wood Association) and public company announcements have suggested was almost 40% during both third quarter and year-to-date. We do expect more downtime will be required in the fourth quarter to manage inventory levels and conserve cash. You will recall in the first quarter of this year we took about 20% of our capacity down when prices were very challenging.

We don’t consider temporary or indefinite curtailments material in the current market environment, and accordingly we will continue our practice of summarizing downtime taken at the end of each quarter.

Our North American OSB mills achieved break-even EBITDA on net sales of $144 million in the quarter. This is the second consecutive quarter our North American OSB operations broke even and we consider this as a significant achievement considering the continuing pressure from rising global energy and resin prices in the quarter.

Our Q3 North American per unit OSB cash production costs were up 5% over the second quarter and 9% over the third quarter last year. The higher cash costs are largely due to higher resin and wax prices, and to a lesser extent, higher fiber and energy prices. We do believe that resin, wax, and wood prices peaked during the quarter and should ease somewhat going forward.

European operations recorded an EBITDA loss of $5 million in the quarter. Year-to-date Europe has contributed positive EBITDA of $8 million. Our European results reflect the sharp slowdown in housing related activity this quarter, especially in the UK. Prices for our European panel products declined 7% on average in Q3. Our European business is also disproportionately impacted by rising global energy and resin prices, as our European panel products are more energy and resin intensive. Resin and energy prices in Europe are running at more than double last year's level. We ran our European mills at 80% capacity during the quarter, compared to 90% in Q2, and 100% in the same period last year. Year-to-date our European mills operated at about 90% capacity.

Operating working capital was negative $10 million at quarter end compared to positive $13 million at the end of Q2, and $127 million at the end of Q3 2007. The decrease quarter-over-quarter is largely due to the $35 million increase in our accounts receivable facility concluded during the quarter, which was partially offset by the $17 million antitrust settlement payment. In spite of the current economic environment, Norbord's accounts receivable metrics remained in line with prior periods.

Operating activities consumed $8 million of cash in the quarter as a result of negative EBITDA and interest paid, offset by a decreased investment in operating working capital. In the prior quarter, operating activities generated $88 million of cash, the majority of which related to the receipt of $85 million of income tax refunds.

CapEx was $7 million in the quarter and $22 million year-to-date. $12 million of the $22 million invested this year relates to the completion of outstanding US MACT air emissions compliance projects. We are now MACT compliant at all of our mills. Our CapEx plan for 2008 has been limited to $30 million and will be further constrained to $25 million in 2009. Net debt stood at $515 million at period end, representing 37% of capitalization on a market basis, and 62% of capitalization on a book basis.

At quarter end, Norbord had $181 of liquidity consisting of cash and cash equivalents, unutilized bank lines and unutilized term debt facilities. Our liquidity position supported another dividend payment this quarter. However, we are in unusually challenging markets and we don't expect to see any near-term recovery in the financial markets or housing starts. The Board continues to look very closely at the dividend each quarter.

We told you for the past couple of quarters that we are considering alternatives to further strengthen our liquidity position and conserve cash as move through this downturn. And I can tell you that we are comfortable with where this process is taking us. We will provide an update if, and when, we have something more to disclose.

And with that, I will turn the call back over to Barrie.

J. Barrie Shineton, President and Chief Executive Officer

Thanks very much Robin. The pleasant surprise this quarter was that North American OSB prices were stronger than we had expected. Looking forward to quarter four, however, we see demand dropping off sharply, particularly after US Thanksgiving. Housing starts are not improving as seasonal construction activity is slowing. And, we will see a cautious buying pattern, as our customers focus on managing their own working capital before year-end. We expect OSB prices to soften from quarter three levels but we don't expect them to return to the very low numbers we saw in the first quarter of this year.

Our operating plan in quarter four is the same as it has been all year. We will monitor mill net and shutdown costs and we will take mills down quickly when it is the prudent financial decision. We won't get any help from the demand side, but as Robin told you earlier, we do believe that prices for resin and wax and wood in some regions will begin to moderate in 2009.

The unpleasant surprise in the quarter was how quickly the UK panel market deteriorated. Housing market conditions, and our own business environment, now pretty much mirror the US. Year-to-date, UK housing starts have come off 40% and the difficulties facing UK builders have been well publicized over the last couple of months. Any recovery there will depend, like in the US, on how quickly financial markets stabilize and when credit becomes available to home buyers. However, there are some important differences in UK housing. The market is not handicapped by high inventory of unsold homes. And, there is a systemic lack of affordable housing and this pent up demand continues to grow. So, when we see a recovery, it may well happen faster than we see it in the US.

Looking ahead, I think, we will face an unprecedented sales environment over the next two quarters, as 2009 housing starts are unlikely to be any better than the 1 million number that we will probably finish this year at.

We are forecasting our North American OSB prices to be modestly higher in 2009, but this will be offset by lower panel board prices in our European business. Against this background, we will not lose our focus on doing the right things to contain costs, service our customers and improve mill productivity. We are going to run our mills hard, when we run and we are going to curtail quickly when it makes financial sense to do so. We will limit the CapEx to $25 million in 2009. We will squeeze more out of SG&A costs, recognizing that we are already pretty lean.

And finally, we will continue to take steps to strengthen our liquidity position and balance sheet.

And with that, I will turn things back over to the operator to open up your lines for your questions.

Q&A

Operator

Thank you. [Operator Instruction]. We will standby for the first question. Our first question comes from Richard Skidmore with Goldman Sachs. Please go ahead.

<Q - Richard Skidmore>: Good morning. Robin, can you just talk about the tax issues, specifically, in the second quarter, you had a big tax refund how should we think about that as you move into 2009, is there another tax refund that you would anticipate in 2009?

<A - Robin Lampard>: Well Rick, I would point to our balance sheet where you will see we have $20 million in the tax receivable line. And so that's what we would expect to receive over the next 12 months. I would say most of that will be in 2009. And that is about the extent in terms of our expectations for tax refund because we have pretty much exhausted our ability to carry back losses as there is only a two year look back in the US.

<Q - Richard Skidmore>: Okay. And then just a second question, with the tightening of the credit markets and the other financial issues that we are seeing, are there any issues with regards to your customers paying you, with regards to customer credits, anything with regard to any delinquencies or anything like that that you are seeing, that might be an issue?

<A - Robin Lampard>: Nothing at all Rick, you may have heard in my prepared remarks that all of our accounts receivable metrics are in line with prior periods, so there is no issue there at all.

<Q - Richard Skidmore>: Okay, great. Thank you.

<A - Robin Lampard>: You're welcome.

Operator

And, our next question comes from Don Roberts with CIBC World Markets. Please go ahead.

<Q - Don Roberts>: Thanks. Yes, the first question is for Robin, could you just update us on your f/x hedging policies and to the extent that they may sort of mitigate the changes in recent currencies?

<A - Robin Lampard>: Well, there is quite a lot of disclosure in our financial statements on how we manage all the risks in our business. You will see that we had no hedges really to speak of in the past year. So, we haven't got anything in place to mitigate one way or another.

<Q - Don Roberts>: Okay. And, this is also for US and the €?

<A - Robin Lampard>: Correct.

<Q - Don Roberts>: Okay. You've discussed before the options for increasing liquidity, could you give a sense for which one or two, perhaps you could lean a little more towards?

<A - Robin Lampard>: Well, all I can do Don is reiterate what we've said and just take a step back and look at our track record. We have a track record of taking very regular steps to boost our liquidity and we have been doing things for the past couple of years. We always share these details with you when they are ready to announce. For example, we issued senior notes early in 2007 to fund our '08 maturity, we put a securitization program in place on our receivables, which has raised $85 million of liquidity. We added a bank to our bank group, which added $35 million. We put the $100 million Brookfield facility in place. And of course, we've done all the things in a more of an operational nature like limiting CapEx, SG&A and constraining working capital. But I think we certainly have a track record of taking regular meaningful action on that front. We will continue to evaluate new ideas and we will share them with you as well when we are in a position to do so.

<Q - Don Roberts>: Okay. Barrie, a sort of a related question, on the dividend issue. I know your Board regularly discusses it, but with the DRIP program in particular especially given the current share price resulting in dilution at this very low share price. How much of a discussion is it with regard to that? Not just the absolute dividend level, but the composition of how you handle it?

<A - Barrie Shineton>: The composition of how we handle what Don?

<Q - Don Roberts>: Well, the dividend, right now you have got the option of paying out in cash or for the Canadian shareholders taking it in stock. That's resulting, given the current share price, in constant dilution at these low levels. And I am just wondering when the Board has this discussions, is that issue of the dilution at these low share prices much of an issue?

<A - Barrie Shineton>: Well, it's comes up in the discussion Don, but we consider it just one more example of the kind of support that we get from Brookfield for our company and it's talked about in that context.

<A - Robin Lampard>: Also, just to remind you Don that any Canadian shareholder can participate in the DRIP and it's completely at a shareholders option, not the Company.

<Q - Don Roberts>: Yeah, okay. Thank you.

Operator

Your next question, the line comes from Daryl Swetlishoff with Raymond James. Please go ahead.

<Q - Daryl Swetlishoff>: Well, thanks. Good morning. Barrie you mentioned that you expect OSB prices to firm up and not test first quarter '08 levels. I was wondering what percent, if you had to guess, of the 40% capacity that you suggest is curtailed in North America, what percent would be in Canada, what's your best guess?

<A - Barrie Shineton>: I think I have talked about that number a couple of calls ago, Daryl. And I wouldn't quite use the word firm up, I think I said modestly better.

<Q - Daryl Swetlishoff>: Modestly better, okay.

<A - Barrie Shineton>: Firm up might be too strong. But, of that 40% we believe a number like 30% is permanently or indefinitely curtailed and I guess this is capacity that can't start-up easily or quickly and the bulk of that is in Canada.

<Q - Daryl Swetlishoff>: Okay.

<A - Barrie Shineton>: Does that help you?

<Q - Daryl Swetlishoff>: It does, just looking at my screen the Canadian dollar at $0.78, is there a chance of some like capacity could comeback at these very low Canadian dollar levels?

<A - Barrie Shineton>: Well you know, we watch the same screens because we have mills in Quebec of course. It absolutely makes our Canadian mills more competitive.

<Q - Daryl Swetlishoff>: Right.

<A - Barrie Shineton>: But, I think with the backdrop of, you know, pretty weak demand in quarter four and quarter one, I am not so sure that Canadian capacity even at the $0.78 or $0.80, dollar will comeback quickly. Remember a lot of these mills have the padlock on door.

<Q - Daryl Swetlishoff>: Right.

<A - Barrie Shineton>: And their workforce has been laid-off and it's not easy for this capacity to come back in short order.

<Q - Daryl Swetlishoff>: Okay.

<A - Barrie Shineton>: For a near term anyway.

<Q - Daryl Swetlishoff>: Okay, Barrie. Thank you.

Operator

Your next question comes from Robert Trout with Goldman Sachs. Please go ahead.

<Q - Robert Trout>: Thanks. Good morning guys. Barrie, I was wondering if could come back to the statement that you made today and for the last quarter about the three kinds of adjustments that you think you are needed before we can get back to meaningful uptick in housing. You mentioned that the inventories have to come down, prices have to get back to normal levels and lenders have to put buyers back in the market. This morning, the existing home sales report came out and it showed that the prices in September hit their lowest level since April of '04 for existing home and sequentially sales were up from August and the inventory fell for the second straight month. So, my question is: do you think that, recognizing we have a long way to go, but this can be sort of the inflection point at the, you know, for all three of those restores that you mentioned.

<A - Barrie Shineton>: I would say; Bob, that we are in the bottom. I wouldn't suggest that what you're reading is an inflection point yet, I wouldn't want to be that optimistic. I think housing starts are going to remain at 2008 levels and could even be a little lower in 2009. So, I was trying to read that release on my Blackberry just before the conference call started. I couldn't quite absorb it all, but I am not that encouraged about our near-term prospects; certainly, in the first half 2009, to be honest. I think we are at the bottom, but I think it's going to take some time, yes.

<Q - Robert Trout>: Okay. Thank you.

Operator

Your next question comes from Sean Steuart with TD Newcrest. Please go ahead.

<Q - Sean Steuart>: Thank you. Good morning, everyone. Barrie, a question on resin, you touched on the fact that you think we've peaked out here and given what we're seeing with the natural gas costs, obviously, expect some a relief. I am just trying to get it sense of how long do you think that lag last and should we anticipate some relief in Q4 or is this going to be more of an early 2009 event from your perspective?

<A - Barrie Shineton>: Early 2009, I think we are getting a sense, but lower energy prices are going to start flowing through into the raw material feed stocks going into resin plants. And we expect to see the pressure ease off through 2009. Our experience has been and our history has been prices don't come off right away.

<Q - Sean Steuart>: Okay. And...

<A - Barrie Shineton>: And there are other components to resin. It's a type used in the agriculture industry worldwide. So, but we think certainly resin and wax have peaked anyway.

<Q - Sean Steuart>: Okay. And the other question I had Barrie was, in Europe, I was wondering if can you differentiate between – you talked quite a bit with the UK market and differentiate what you seeing there with Mainland Europe and any differences in trends there?

<A - Barrie Shineton>: You'll recall from my comments on the UK market, that's where the deteriorating business conditions had been most pronounced. For us, the same things are happening on the continent but it's not the same sharp decline as they came off in the UK.

<Q - Sean Steuart>: Okay, that's helpful. Thank you.

Operator

The next question in the line comes from Angie Salam with Deutsche Bank. Please go ahead.

<Q - Angie Salam>: I know you don't plan on giving us any other color on the measures you are taking to improve liquidity, but could you update us on the covenants under the credit facility. I believe you are getting close to approaching some of those levels and are you in talk with the banks right now?

<A - Robin Lampard>: Well Angie of course we are always in discussion with our bank group. That goes for at any point in cycle, but certainly at this point in the cycle we're obviously in touch with them a little more regularly, and so, as we said we are looking at a number of things and when we have something to announce then we will do so.

<Q - Angie Salam>: Okay, just one followup. I mean the big credit markets being in the flux they are now and banks in general being more restrictive on who they lend to across all companies, are you getting any sort of indication that one of your banks may walk away if the covenants are breached?

<A - Robin Lampard>: Well I think as you heard me say in the prepared remarks we are comfortable with where the process we are in is taking us and so that's all I can say at this point.

<Q - Angie Salam>: Okay. Thank you.

<A - Robin Lampard>: You're welcome.

Operator

And the next question comes from Michael Boam with BlueBay Asset Management. Please go ahead.

<Q - Michael Boam>: Hi, this Mike Boam from Bluebay. I just have some followup on this point, if I may. In terms of covenants, you could trip the next quarter. So, therefore I would suggest your conversations are starting more urgent, so we say at the moment. But I know from your bond indentures that you are not allowed to secure any debt ahead of the bonds, given the negative pledge. Are you sort of -- is one of the things you are looking at global recapitalization at the present time?

<A - Robin Lampard>: You are right, on the bond indentures there is a negative pledge that does prevent security to the bank ahead of the bond holders, so that's not an issue if you are bond holder. But I can just reiterate what we said so far is that we are – for the past couple of quarters we've been in a process of looking at alternatives and we are comfortable with where that process is taking us.

<Q - Michael Boam>: Does that include in anyway the raising of significant equity at this point.

<A - Robin Lampard>: I think you've heard me say last quarter that all options are on the table and there is nothing further to say until we have something to disclose.

<Q - Michael Boam>: Okay. Thank you.

Operator

And our next question comes from Philip Acinapuro with Scotts Cove Capital. Please go ahead.

<Q - Philip Acinapuro>: Thank you. My question has been answered already.

Operator

Thank you. I will now turn things back over to Mr. Shineton. Please go ahead.

J. Barrie Shineton, President, Chief Executive Officer, Director

Thank you Marcus and thanks very much to everybody for joining us in the call. You know you can always talk to Robin, Anita or me if you want to and we will respond to any questions you might have. So, thanks again for participating and we will talk to you again in January.

Operator

Ladies and gentlemen, this does conclude the conference call for today. We thank you for your participation. You may now disconnect your lines and have a great rest of the day.